APPENDIX A

Excerpts from transcript of oral argument in the Supreme Court of the United States in *United Shoe Machinery Corporation* v. *United States*, October Term, 1953, No. 394

Argument of Mr. Branch, counsel for United:

The only one of United's three principal sources of power which the court found was not plainly beyond reproach consisted of those practices which the court lumped in the phrase "the leasing system."

As Mr. Proctor pointed out, the leasing system was used by United always, it had been used by the constituent companies of which United was formed, it is used by United's competitors, and the important features of that are that, as to the more important complicated machines, United does not offer them for sale.

It offers them only for lease, and furnishes service, not only repair service, but other types of service, without additional segregated charges. (p. 31)

The Chief Justice: Have these competing companies been using practically the same leasing system that you have through the years?

Mr. Branch: Yes.

The Chief Justice: Or is that a recent performance?

Mr. Branch: Oh, no, they have always done it, and they have always offered their more important machines for lease only and have furnished service without segregating charge, and they are going to be allowed to continue to do

it, although we are going to be prevented from doing it. (p. 46)

But we say — and I realize how diffident one should be in saying this — that certain finding of fact by the court below, much as we respect Judge Wyzanski, were clearly erroneous, and the ones I want to refer to particularly are those which I will read, which he expressed this way:

> "The complex of obligations and right accruing under United's leasing system in operation deter a shoe manufacturer from disposing of a United machine and acquiring a competitor's machine, and he is," I quote again, "deterred more than if he owned that same machine."

That was a basic finding on which the decision rests. It rests on the leasing practice and the objection to the leasing practice really comes down to that. (p. 52)

Argument of Mr. Spritzer, counsel for the Government:

Now, getting to the leasing system, and we use the words "leasing system" very broadly to include the unwritten practices as well as the written provisions of leases, and also to include the servicing and pricing of leased machinery — getting to the leasing system, the first point to be noticed is that while United offers some machines on an outright sale or on an optional, that is leased or sale, basis, its important machines, almost without exception are available on lease only, and I might state before I go any further, that I am going to be discussing many different features of the leasing system, and I think it is, as the Court said, the cumulative effect of this or of these which one has to consider.

Justice Reed: What is the Government's objection to the leasing system?

Mr. Spritzer: That it is exclusionary, discriminatory, anti-competitive and unfair. I think I can only develop that in terms of the facts. (pp. 84-85)

Mr. Spritzer: Under the decree, the lessee will be able to terminate after one year. The leases will be for a five-year period, but there will be a power of termination earlier. Of course, there will be an option that the lessee will have to buy rather than to lease, and many of the more objectionable and restrictive features and discriminatory features will be eliminated, so we think the decree does hold some promise, modest though it is. (pp. 85-86)

Justice Frankfurter: The decree now gives a choice initially, but from the period, tenure of the lease, the term of the lease, the initiative is there to buy rather than to let?

Mr. Spritzer: Yes. United is required to offer an option to purchase any machine which it elects to offer on lease.

Justice Frankfurter: Did the Government take the position that wholly apart from the terms of the leasing system, leasing as such is one of the something or other unusual, unnatural barriers?

Mr. Spritzer: No, indeed. We did not ask that leasing be prohibited.

Justice Frankfurter: You did not?

Mr. Spritzer: No.

Justice Frankfurter: So that leasing itself cannot be one of the monopoly-aiding instrumentalities?

Mr. Spritzer: It is this leasing system as practiced.

Justice Frankfurter: Under the terms, aside from that, leasing as such, you did not ask to be outlawed?

Mr. Spritzer: No, we asked for the option, which the Court ordered. (pp. 87-88)

APPENDIX B

Excerpts from Findings of Fact, Conclusions of Law and Opinion of Judge Sheridan dated April 28, 1965 in the United States District Court for the Middle District of Pennsylvania (A 81-96) 245 F. Supp. 287-294

E. Damages.

1. The Leidesdorf Calculations.

The primary damage claimed by Hanover is the excess of leasing cost over what it would have cost to own the same machines had they been available for purchase during the period from July 1, 1939, to September 21, 1955. This required, among other things, a determination of what the purchase prices would have been. The first time the lease-only machines were offered for sale was in 1955 when United established prices for the sale of its machines new (1955 prices). Hanover's proof consisted of the following steps.

a. The cost to Hanover of the machines presumably purchased by it in 1939, or in any subsequent year when additional machines or replacement machines were presumably acquired by it, was determined by applying the Bureau of Labor Statistics Consumer Price Index, All Items, for the years of acquisition, to the 1955 prices.

b. The cost so determined was reduced by the residual value of (1) machines deemed to have been disposed of at the end of an assumed life expectancy and (2) machines on hand on September 21, 1955, the date of the commencement of this action. The reduction was determined by first applying to the 1955 prices the discount table that had been negotiated between United and N. S. M. A. pursuant

to the order of the district court (the discount table). Then the Bureau of Labor Statistics Consumer Price Index, All Items, for the years of disposition prior to 1955 was applied to the discounted prices.

c. The difference between a. and b. was subtracted from the total rents and royalties paid by Hanover during the complaint period.

d. The estimated cost to Hanover of servicing the machines it presumably purchased was deducted from the remainder. For the 20 major machine types this service cost was based upon the actual service costs Hanover incurred when servicing the 20 major machine types during the year September 1, 1961, to August 31, 1962. No allowance was made for the lower costs that would have been incurred during the complaint period. For the remaining 37 machine types, the service cost was determined by taking that proportion of the service costs for the 20 major machine types for the year ending August 31, 1962, which rents and royalties paid on such 37 machine types bore to the rents and royalties paid on the 20 major machine types.

Three separate calculations were prepared by S. D. Leidesdorf & Co. (Leidesdorf), Certified Public Accountants, all of which are based substantially on this method, differing mainly in the life expectancy assumed for the various machine types. One was based on a study of the life expectancies made by Professor Joel Dean, an expert employed by United, and used by it in the course of the negotiations with the N. S. M. A. A second was based on a fifteen year life expectancy, accepted by the Internal Revenue Service for shoe machinery, for all machine types. The third was based on a life expectancy determined from the actual shipments of machines by United to Hanover, and the actual returns of machines by Hanover to United.

The damages shown by the three calculations vary between $1,821,431.77 and $1,836,060.90.

United raises several objections to this proof, which it contends renders it "speculation or guesswork" and not within the guidelines established in Keogh v. Chicago & Northwestern Ry. Co., 260 U. S. 156, 43 S. Ct. 47 supra, and Bigelow v. RKO Radio Pictures, Inc., 1946, 327 U. S. 251, 66 S. Ct. 574, 90 L. Ed. 652.

The first objection is that the Leidesdorf calculations are merely mathematical calculations based on assumptions which have not been proven.

The Discount Table. United says it accepted the discount table under the pressure of the decree and the supplemental opinion of March 8, 1955, in the Government case, and after strenuous bargaining with N. S. M. A., and that Hanover used it, without further proof, in fixing the salvage value at given dates of the machines assumed to have been purchased at prior dates.

Hanover was faced with the necessity of establishing a value for machines on hand at the date of commencement of the action, or which had been disposed of previously, to be deducted from the computed costs of machines assumed to have been purchased to arrive at a computed net cost of ownership. Since there was no market price for secondhand machinery, Hanover used the discount table which reflected age and other conditions. It had no alternative.

United offered testimony that the prices established by application of the discount table did not take into account actual value. This cannot be accepted. Value has different meanings to different persons. The discount table was negotiated. Negotiation is a process of submission and consideration of offers until an acceptable offer is made and accepted. United States v. John McShain, Inc., 1958, 103

U. S. App. D. C. 328, 258 F. 2nd 422, 424, cert. denied 1958, 358 U. S. 832, 79 S. Ct. 52, 3 L. Ed. 2d 70, United's contention, in effect, that it was forced to agree to such prices, is without merit. The decree required United, within certain time limits, only to present a plan for the termination of outstanding leases and for the sale of the lease-only machines. There was no attempt to dictate prices, or to force United to accept unreasonable lease and sale terms. Judge Wyzanski's supplemental opinion merely required United to disclose the data on which Joel Dean's calculations were based. Its purpose was to remove unnecessary roadblocks in the negotiations. It did not force terms on United or require it to accept the terms of N. S. M. A. United offered no evidence that the sales prices were in fact unreasonably low. The use of the discount table was proper.

Date of Commencement of Action. The salvage value of machines assumed to have been purchased is supposedly increased because the discount table assumes September 21, 1955, as the correct date for cutting off the estimated life of the machines, thereby diminishing the net cost of ownership. United has not suggested any other date.

The applicable statute of limitations is measured from the date the action was begun, September 21, 1955. Since this is the end of the damage period, the comparison of rental costs to cost of ownership would have to include machinery values established no later than September, 1955, for those machines assumed to be on hand at that date.

The 1955 Prices. United next argues that the sales prices constructed by Hanover assume, without any proof, that if prices were established by United for machines in 1939 and subsequent years, it would have established the prices so constructed, even though the 1955 prices were fixed under 1955 economic conditions, and under the man-

date of the decree providing that sales prices could not be fixed so as to make it substantially more advantageous to lease, and that this is sheer speculation because those economic and legal conditions did not exist in 1939 and later years.

The issue is whether the prices computed by Hanover are reasonable. Dr. Corson testified that the 1955 prices, with the application of a proper index, were essential to the calculations. The 1955 prices have been adjusted to reflect economic conditions existing at the time the assumed purchases were made. The limitation that it could not be more advantageous to lease did not depress prices, because rents and royalties were not fixed or regulated. United had complete freedom to fix its lease terms and sales prices at any level. The limitation is not material to the reconstructed prices. The 1955 prices were not an assumption but a fact. The consumer price index used was also a fact.

Machine Shipments and Returns. United next argues that the Leidesdorf calculations include a practical suppression of machine returns, which occurred often, in that returns "... are treated most artificially through a series of accumulations until the totals accumulated reach the totals previously leased, when the deductions are made to show a putative transaction of indefinite character looking like a re-sale ...," and whether or not this treatment favors United, the result is "... unjustifiable as a matter of principle in falsifying the facts concerning machinery returns by which the court and the parties are bound in the ascertainment of 'damages' "; that "... ignoring returns under Form A leases until cumulative returns had exceeded cumulative shipments, is only another indication that the Leidesdorf procedures rest on the speculation that every machine in fact returned could and would have been promptly sold upon a different market at an established price. ..."

The argument is not clear and appears to misconstrue the manner in which machine returns were considered in the calculations. As a part of its approach, Hanover had to determine how many machines, if purchased, would have been required to maintain its production. Between 1939 and 1955 machines were received from United and returned to United. Hanover did not credit itself with the return of a machine because the shipment and return data showed the return in a particular year. This was in order not to take advantage of returns a lessee, and not an owner, might make because of cyclical fluctuations in production. Hanover credited itself with returns only to cumulatively offset shipments at a given time, and shipments were considered purchases only when shipments exceeded returns at a given time. This is reasonable and does not render the calculations speculative or conjectural. If Hanover had used individual returns, it would have increased the damages. United has not proved that a consideration of individual shipments and returns would decrease the amount of damages.

2. Elements Not Included in the Leidesdorf Calculations.

United attacks the Leidesdorf calculations because cost of capital, future worth and taxes are not included, and a proper index was not used.

Cost of Capital. The Leidesdorf calculations do not include cost of capital. Cost of capital is an economic concept which has been defined as "the rate of return expected by investors on capital funds they place at . . . [a concern's] disposal." Dr. Corson testified that a company usually gets its capital in four ways: debt, preferred stock, common stock and retained earnings, and that during the damage period Hanover derived its capital from the sales of common stock and retained earnings. He computed Hanover's

cost of capital in two ways. First, he took the percentage of earnings per share to the price per share of common stock for the seven years (1940, 1941, 1942, 1948, 1949, 1950, 1951) in which common stock was sold. The weighted average was 22.14 percent. He also took the percentage of net profit after taxes to stockholders' equity for the years 1939 to 1955. This average was 14.1 percent. Using the 14.1 percent, Dr. Corson made certain adjustments to the calculations. He concluded that purchases would not result in an investment return greater than the cost of the capital invested, and that the purchases were economically unsound.

If cost of capital is a necessary element of the damage calculation, the rate used by Dr. Corson does not reflect the true cost that Hanover would have had to pay or offer to attract capital. The measurement of cost of capital is vague. "Quite apart from the practical difficulties of measuring capital cost for a specific company, there is today no explicit and generally acceptable account of what is the correct concept, actual approach to its measurement. . . . The best known exception is the work of Professor Joel Dean but even his most comprehensive statement regarding the cost of capital is neither explicit nor complete." Solomon, The Management of Corporate Capital. Dr. Corson cited this work and that of Joel Dean in support of his testimony. "A person who desires neat solutions with one correct answer should avoid the computation of a corporation's cost of capital. Usually such an answer is impossible. If ten 'experts' independently computed the cost of capital of the IBM Corporation, there would be ten answers." Bierman & Smidt, The Capital Budgeting Decision. While Dr. Corson also cited this work, he disagreed with this particular view. Dr. Cyert, Hanover's expert, agreed with these authors, and listed other authorities who emphasize the difficulties in the measurement of the cost of capital.

The inexactness in its measurement is demonstrated by Dr. Corson's averages of 14.1 and 22.14 percent. The percentage of earnings per common share to price per common share ranged from 7.8 percent in 1940 to 54.5 percent in 1948. The percentage of net profit after taxes to stockholders' equity, while not fluctuating as sharply, ranged from a low of 6.72 percent in 1945 to a high of 32.59 percent in 1947. To demonstrate the inexactness also, Hanover suggests that the percentage of earnings per share to the sales price per share on a secondary issue of Hanover stock in 1956 was 8 percent. This was the first public sale of Hanover stock. Prior to that time, stock acquisition rights were limited to descendants of the original founders of the company, and certain key employees, and sales were at a discounted price reflecting book value after certain downward adjustments of capital and surplus in accordance with a predetermined formula. Both experts agreed that in measuring cost of capital in this way market value is used, and if there is no market value, then the market value of stock of similar companies. Yet, Dr. Corson was satisfied with discounted sales to family and key employees. Mr. Spence, who for many years dealt in corporate stock and securities matters, testified that during the damage period Hanover's stock, if publicly sold, would have had a market value of a minimum of ten times earnings, and probably as high as 13 times. This would indicate a cost of capital of 8 or 10 percent. Mr. Spence's opinion was based in part on the market value of stocks of other shoe manufacturers. Dr. Corson thought that the 1956 public issue was not relevant to the damage period, and that the market price of stocks of similar companies were not material because his figures were the actual cost of capital experienced by Hanover. This ignores the fact that the bulk of the assumed purchases would have been in 1939.

The evidence shows that these purchases would have resulted in a cost of capital different than that actually experienced during the damage period.

Hanover had other sources of capital. It made substantial loans in 1942 and in 1951 at interest rates of 2 to 2.5 percent. In 1942 it borrowed $300,000 without interest from two of its "family" stockholders. The borrowings were infrequent and for the most part relatively small—5.8 million during the same period, with 2.1 million the largest amount outstanding at any one time. ($535,000 is the approximate cost of the machines to Hanover in 1939.) Dr. Corson did not consider debt because he concluded it was not a principal source of capital.

Dr. Corson did not consider preferred stock as a source of capital. In 1946, Hanover issued 2.5 million of preferred stock with a 5 percent dividend. Dr. Corson said capital "was not derived in any significant part from preferred stock. . . ." It has enough significance so that it should not have been ignored as an independent source. Moreover, in arriving at the 14.1 percentage, stockholders' equity, to which profit after taxes was compared, included preferred stock. Dr. Corson said this rate was "what the stockholders essentially earned on the money they had supplied and supplied either by the purchase of stock or by the retention of earnings. . . ." The preferred stock was non-participating, and, thus, to the extent that such profit exceeded the preferred dividend rate, it does not represent what preferred stockholders earned on their capital.

Dr. Corson admitted that his figures do not represent a cost in an accounting sense. He testified that a concern which has a cost of idle capital of 14 percent and which borrows additional capital at 2 percent, and invests it at a 10 percent return, makes a profit for income tax purposes, but suffers an economic loss. He testified that an economic

loss and actual profit and loss are not the same, and that such an economic loss, while difficult to identify in the profit and loss statement in any year, in the long run will be reflected in the profit and loss statement. To include the cost of capital in Hanover's damage calculation would require an examination of the wisdom of every corporate investment. While Dr. Corson admitted that Hanover at all times had sufficient capital to purchase the machines, there is no evidence why Hanover borrowed from time to time. In many instances the loans were less than the amounts of the assumed capital purchases. Such a corporate decision to borrow funds, under Dr. Corson's testimony, would be unwise. It illustrates that a company may choose to act notwithstanding the cost of capital indicated that it should not.

Dr. Cyert, on the other hand, emphasized that the cost of capital is only a decisional guide which should form no part of a damage calculation.

In the Borden Co., 1962, 3 CCH Trade Reg. Rep. para. 16,191, a Federal Trade Commission case, Borden attempted to defend a charge of illegal price discrimination under the Robinson-Patman Act on the ground that differences in prices resulted from differences in costs. One element of cost was "Investment Cost" which appears to be of the same nature as the cost of capital. The Commission rejected it as a proper cost item:

> "Respondent's cost study fails for other reasons. For instance, it claims an 'Investment Cost' difference of $.0404 per case. Respondent apparently kept larger inventories of Borden brand evaporated milk than of the private label. In its analysis, it concludes that the money invested at 8% resulted in an inventory cost of $.0835 per case for Borden brand and an inventory cost of $.0257 per case for private label. The fallacy in this position is that the so called 'Investment Cost' is not an actual, incurred cost at all; it amounts to a return on

capital investment. Accordingly, this item is rejected for cost jutification. Cf. Thompson Products, Inc., 55 F. T. C. 1252, 1265-1266 (1959)."

On the record there is no clear measurement for cost of capital. Even if measurable, it is not a proper element of the damage calculation. Cost of capital is a guide, not rigid or inflexible, which with other considerations such as opportunity, preference, necessity and the like, may dictate action and policy. Cost of capital, other than interest on borrowed funds, is not an item of cost or expense that would directly affect Hanover's profits and losses in any year. The financial statements and the testimony of Dr. Cyert and Mr. Spence, however, indicate that Hanover would have borrowed the necessary capital for the purchase. The calculations should be adjusted to reflect a 2.5 percent interest rate.

Future Worth. United argues that future worth is a mere matter of compounding the actual machinery investment at the appropriate cost of capital; that its application to the calculations is proper because "Anyone can see that, if Hanover could have put the purchase price of machinery in a savings account and obtained over 16 years a compounded return on its money at the rate of 14%, it would be folly to make the same investment in a purchase that would not earn at least that rate of return."

Future worth does not represent a cost to Hanover. The compounding of alternative investments at the given rate over a given period indicates which investment provides the greatest return. But again it is only a guide. It does not reflect other considerations such as opportunity, preference and necessity. It does not directly affect the profit and loss statements, and would not directly enter into the determination of profit and loss in any year. The damages will include interest on the borrowed funds. Future worth is not a proper element of the damage calculations.

Taxes. Any recovery by Hanover will be subject to taxation in its entirety. Commissioner of Internal Revenue v. Glenshaw Glass Co., 1955, 348 U.S. 426, 75 S. Ct. 473, 99 L. Ed. 483. The Leidesdorf calculations do not take into account tax consequences, such as deductions for rents and royalties, and capital gain treatment for machines disposed of at greater than depreciated book value. Generally in tort and in breach of contract actions taxes are not considered in assessing damages. The cases are collected in 63 A. L. R. 2d 1393 and 1433. In Cereal Byproducts Co. v. Hall, 1958, 16 Ill. App. 2d 79, 147 N. E. 2d 383, the court held that an income tax refund received by plaintiff as a result of embezzlements should not be considered in mitigation of damages for defendants' failure as auditors to uncover the embezzlements:

> "... On defendants' theory every suit for damages would necessitate consideration of the income taxes saved by the plaintiff on account of the loss and the taxes payable on account of the recovery. The same principle applies as would apply in the event plaintiff had carried insurance against these embezzlements. Neither payments by the insurance carrier nor tax refunds can mitigate defendants' liability. The insurance carrier would have an interest in the recovery from the defendants just as the federal government has a tax interest in the recovery by plaintiff. We think that the court erred in giving defendants credit for the income tax refund."

In the trial on the separate issue, the late Judge Goodrich said: "Things which happen later and let an injured plaintiff escape some of the ultimate consequences of the wrong done him do not inure to the benefit of the defendant. . . ." 185 F. Supp. 826 at page 829, supra. The tax consequences are extraneous to the damage caused by United, and are not a part of the calculations.

Consumer Price Index. There is no price index for shoe machinery. Dr. Corson testified that the Consumer Price Index was not proper for the conversion of shoe machinery prices because the index is constructed to measure commodities that wage earners and clerical workers "purchase as their cost of living" such as food, clothing, toys and the like; and that a more precise index would be a "leasing cost index," which would "relate the prices of shoe machinery in 1955 to hypothetical prices—because that's what we are dealing with—in the earlier years as the rentals in 1955 varied in earlier years." He did not detail the mathematics, but estimated under this index an increase by 20 percent of the excess of cost of ownership over cost of leasing, calculated after the inclusion of the omitted elements. His work papers showed that the computed net cost of ownership was $71,000 less than that arrived at through application of the Consumer Price Index. If the index were the only matter in issue, and Dr. Corson's index were used, Hanover would be entitled to an additional $71,000. However, through application of the omitted elements, this index produced a result by which a computed excess of cost of ownership over cost of leasing went from $949,720 to $1,169,366.*

Dr. Cyert testified that the Consumer Price Index is a reasonable indicator of the general price level and the general trend of prices, since it is based on a measure of the cost of living for a large segment of our society, and while there is no measure for everything that happens in our many dimensioned society, the index was reasonable and a proper one for this case. The Consumer Price Index resulted in a relationship of 1939 prices to 1955 prices of 51.9 percent.

* Using the Consumer Price Index and including the omitted elements, Dr. Corson has computed an excess of ownership costs over leasing costs of $949,720.

Using a leasing cost index based on the 20 major machines in the damage calculation, the percentage was 52.9. And with an index developed from United's prices for its optional machines the percentage exceeded 51.9 only in the case of two of the 58 listed machines. The application of the Consumer Price Index was proper.

Expert Testimony. It is not clear whether United contends that expert testimony was necessary to prove all elements of the calculations. Whether expert opinion is required is a matter within the discretion of the court. Conry v. Baltimore & O. R. Co., 3 Cir. 1953, 209 F. 2d 422. Expert testimony is permitted if the court determines it is necessary to aid the fact finder in a full understanding of the issues. Steward v. Atlantic Refining Co., 3 Cir. 1957, 240 F. 2d 715. Expert testimony to support the calculations was supplied to the extent needed. Dr. Cyert gave his opinion on the propriety of certain elements used in or omitted from the calculations. The adverse opinion of Dr. Corson clearly defined the issues, so that the court is in a position to decide them. United's criticism of the testimony of Dr. Cyert is not supported by the record. Moreover, the underlying factual data was proved, and the assumptions on which the calculations were prepared were reasonable.

In William Goldman Theatres, Inc. v. Loew's, Inc., E. D. Pa. 1946, 69 F. Supp. 103, *aff'd per curiam,* 3 Cir. 1948, 164 F. 2nd 1021, *cert. denied,* 1948, 334 U. S. 811, 68 S. Ct. 1016, 92 L. Ed. 1742, the trial court said:

> ". . . Naturally, the plaintiff could offer no record of past performance at the Erlanger. The defendants' wrongful conduct precluded it from doing so. In its place, the plaintiff produced complete data showing the business done and profits earned at each of the other first-run theatres in Philadelphia, including

the nearby Mastbaum, during the damage period. Is this evidence sufficient? . . .

"I do not pretend that there is not an element of speculation or guesswork in making an estimate of probable profits on the evidence presented. The fact, however, that only approximate accuracy is required by the decisions of the Supreme Court indicates that no one expects the impossible and that every estimate of what would have occurred under hypothetical conditions is bound to contain elements of speculation. But the evidence, I think, is sufficient on which to reach a reasoned conclusion the basis of which is relevant, informative and logically significant data."

The damage calculations, subject to an adjustment for interest and to the elimination of certain machines, provide an approach and rational basis for a reasoned conclusion.